United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1289

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United States Court of Appeals

For the Second Circuit

FRANK J. CRIMMINS,

Plaintiff-Appellant,

against

AMERICAN STOCK EXCHANGE, INC.,

Defendant-Appellee.

On Appeal from the United States District Court
for the Southern District of New York

REPLY BRIEF OF PLAINTIFF-APPELLANT FRANK J. CRIMMINS

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Docket No. 1289/74

FRANK J. CRIMMINS,

Plaintiff-Appellant,

-against-

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Defendant-Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF PLAINTIFF-APPELLANT FRANK J. CRIMMINS

STATEMENT

The Exchange* has now succeeded in ending Crimmins' 17-year career in the securities business. On this Appeal, Crimmins seeks relief from that unconstitutional penalty, imposed after inadequate and unfair notice and an unfair

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* All terms used herein are as defined in plaintiff-appellant's main brief on appeal dated April 15, 1974 ("Main Brief" or "MB").

hearing, based on an undefined standard and on conclusions contrary to law. The following facts are undisputed:

In 1968 and 1969, when Crimmins was a Walston branch manager and registered representative, Walston maintained an underwriter and investment banker relationship with FSN. Crimmins, like other salesmen in his and other firms, recommended FSN stock to customers. Crimmins also came to know certain members of FSN management, with Walston's approval and encouragement, <u>but at no time did he obtain or use inside information and neither the Exchange nor the court below has so found</u>.

When the Exchange, in 1969, questioned the wisdom of Walston's permitting sales staff to have contacts with FSN management while recommending its stock to customers, Walston examined the facts and replied that it was fully aware of the management contacts, had found no leak of inside information to its sales staff and would continue to encourage its staff to recommend FSN stock. The Exchange never countermanded Walston's instructions to Crimmins, nor did it during this period ever give Crimmins any direction in the matters involved here (MB at 25-26).

Crimmins had made two 10,000 shares purchases of restricted FSN stock from three members of FSN management at the normal discount for restricted stock. These purchases were paid for in cash and notes; Walston did not require that such purchases be submitted to it for approval.

Walston learned of the purchases in 1969 and said they were proper. However, the Exchange later seized upon them as further evidence of a so-called "special relationship" between Walston and FSN which, according to the Exchange, required Crimmins and others to refrain from recommending FSN stock. At that time, there was no Exchange, SEC or other prohibition against solicitation of purchases absent actual possession of inside information.* The Exchange did not find that Crimmins had possession of inside information, only that he was "in a position to know" of inside information (130a).

When it was discovered that FSN management had defrauded the public through publication of false financial statements, the Exchange insisted that Walston be punished. It extracted consents to 30 day suspensions from Walston's president and several of its senior officers, including two who later pled guilty to criminal fraud in connection with FSN. However, when the Exchange sought to impose a 90 day suspension on Crimmins, he would not consent to such an extreme and unfair penalty, and a formal proceeding followed.

The Exchange denied Crimmins' request that he be represented by counsel at that proceeding and Crimmins brought

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* Indeed, even the less debatable issue of whether actual possession of inside information requires a broker-dealer to cease solicitation was recently certified to this Court as a question of first impression, Slade v. Shearson, Hammill & Co., Current CCH Fed. Sec. L. Rep. ¶ 94,439 (S.D.N.Y. Mar. 18, 1974).

an action in the District Court to require that the proceeding comply with due process, including representation of counsel. The Exchange opposed that application on the grounds that it was not bound by due process. Judge MacMahon held, in Crimmins v. American Stock Exchange, Inc., 346 F. Supp. 1256 (S.D.N.Y. 1972), and the Exchange now concedes, that it is so bound. However, despite advice from the Exchange that it was about to amend its rules to permit representation by counsel, Judge MacMahon ruled that counsel was not required at Exchange hearings; 346 F. Supp. 1261.

The Exchange then proceeded to conduct the hearing described in Crimmins' Main Brief. The Main Brief shows how the Exchange's notice and hearing, the conclusions reached by the Panel and the penalty it imposed, violate due process. As shown below, the Exchange's answering brief ("Exchange Brief" or "EB") concedes some of Crimmins' points, ignores others and fails to meet the rest.

The Exchange is in error in describing this as Crimmins' third appeal (EB at 5). His position is comparable to that of an appellant from an SEC decision. The Exchange's Board of Governors provided only a businessman's review on the facts and not on the legal issues presented here. The unconstitutionality of the Exchange's actions urged in the District Court and on this appeal can properly be argued only

before a court of law. On the issues presented here, this is the first appeal.

The penalty imposed by the Exchange commenced on April 23, 1974 and Crimmins is now unemployed.

I

THE EXCHANGE HAS NOT MET CRIMMINS' ARGUMENT THAT THE DISTRICT COURT APPLIED THE WRONG STANDARD OF REVIEW.

As shown in the Main Brief, the District Court erroneously addressed itself to contentions by Crimmins that the Exchange used unconstitutional procedures and relied on wrong conclusions of law, as though these were only questions of substantial evidence (MB at 9-12). The Exchange does not really dispute this error of the Court below, but only argues that, indeed, the substantial evidence tests have been met (EB at 17) and that the District Court need extend its review only to determine whether the penalty imposed was within the Exchange's power and not arbitrary (EB at 18).

The Exchange's response is a partial concession of Crimmins' point. It is also an attempt to confine that point solely to the court's review of the penalty imposed. As should be obvious, Crimmins' argument on the Exchange's harsh penalty

is but the last in a series of arguments directed to the methods used by the Exchange in this proceeding. The District Court apparently concluded that if the record could support the Panel's findings and conclusions, there are no grounds for objection to violations of the notice and fair hearing requirements. As shown in the Main Brief, this is contrary to law, Jaffee & Co. v. SEC, 446 F.2d 387 (2d Cir. 1971).

II

THE EXCHANGE HAS CONCEDED THAT ITS NOTICE WAS NOT SPECIFIC AND THAT NEW CHARGES WERE RAISED AT THE HEARING.

The Main Brief showed that the Exchange's notice left Crimmins unable to answer so basic a question as whether he was accused of having obtained or misused inside information (MB at 15-17). The Exchange's response is that Crimmins is creating ambiguities and disingenuously fragmentizing Charge 1 (EB at 23). According to the Exchange, notice need not be fully informative if it includes the magic words "course of conduct", particularly where violations of ethical standards are alleged (EB at 23). This was also the basis of Judge Lasker's dismissal below of Crimmins' argument on this point (173a). This reasoning, if accepted, would completely eviscerate the requirements of "fair notice". The words "course

of conduct" do not answer the very real questions created by the Exchange's notice and asked in Crimmins' Interrogatories (99a-114a), and they are no substitute for the fair notice required by law, Jaffee & Co. v. SEC, supra.

The Exchange argues that Crimmins should have understood the Charges since "[t]he Panel members...had no trouble in understanding the Charges...." (EB at 31). Crimmins' Main Brief showed that the Panel had the same trouble understanding the Charges that Crimmins did. The Panel chairman went so far as to ask the Exchange's counsel to "help the Panel" understand Charge 1 (MB at 17).

The Exchange concedes that new charges were raised at the hearing which were not contained in its notice (EB at 26), however, it calls these "minor references to extraneous matters" and says that they did not contribute to the Determination (Id.). Yet, two pages later in its brief (EB at 28), the Exchange argues that evidence on one of these "minor references", as to disclosure to customers, was given "appropriate weight" by the Panel. Indeed, as shown in the Main Brief, the Determination found Crimmins to have breached a duty of disclosure to his customers (MB at 19-20) despite the fact that the Charges (91a-98a) make no such allegation and do not even refer to disclosure.

The Exchange seems to argue that it was not confined to the Charges in its notice because Crimmins was afforded

other rights such as counsel and cross-examination (EB at 26-27). The Exchange offers no explanation of how counsel and cross-examination can substitute for knowing what accusations will be made at a hearing.

The balance of the Exchange's argument on this point is an admission that charges not previously specified were raised at the hearing, but a claim that there was no prejudice since Crimmins cannot show how these allegations contributed to the Determination.

This argument ignores the facts that the new disclosure to customers charges was, in the words of the Exchange, given "appropriate weight" by the Panel (EB at 28) and was incorporated into findings of the Panel. Even if this were not so, "notice" and "due process" would be meaningless terms, if an agency could hear irrelevant, prejudicial* evidence but escape reversal by the simple precaution of making no mention of that evidence in the agency decision. As the Supreme Court noted in Re Ruffalo, 390 U.S. 544 (1968), new and previously unalleged charges of misconduct always result in prejudice; Id., p. 551, n. 4.

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* The new matters raised at the hearing (MB at 19-23) were by their nature prejudicial; see IIIA J. H. Wigmore, Evidence, § 980a (1970), J. Prince, Richardson on Evidence, § 518, p. 526 (1964). It is improper for the Exchange to impose an impossible requirement that Crimmins "prove" the actual, subjective effect of those matters on the Panel's thought processes.

III

THE EXCHANGE HAS FAILED TO MEET CRIMMINS' ARGUMENT THAT ITS STANDARD WAS UNCONSTITUTIONALLY VAGUE BECAUSE RESPONSIBLE MEN DIFFERED ON ITS APPLICABILITY TO CRIMMINS' CONDUCT.

Crimmins' Main Brief demonstrated that a standard is unconstitutionally vague when "men of common intelligence must necessarily guess at its meaning and differ as to its application". *Connally* v. *General Construction Co.*, 269 U.S. 385, 391 (1926) (MB at 27-28).

The Main Brief also showed that the *only evidence* in the record was that all the experts Crimmins looked to, including Walston's president, its compliance officer and its house counsel, reviewed the conduct alleged in Charge 1 and Charge 3 and approved that conduct (MB at 25-26). At the time involved, even the Exchange agreed that no impropriety was present (MB at 25-26). Crimmins showed that, at the time, the question of employee contacts with management was so "murky" an area that no broker-dealer or regulatory agency had focused on it (decision by Judge Tyler, *SEC* v. *Lum's, Inc.*, 365 F. Supp. 1046 (S.D.N.Y. 1973), quoted at MB, 26). The Exchange, for its part, presented no evidence as to the standard applicable at the time in question.

The Exchange now argues that "just and equitable principles of trade" was a known and defined term in the

brokerage community (EB at 37-38). Crimmins uncontradicted evidence showing that the conduct in Charge 1 was not in 1969 considered a violation of just and equitable principles of trade, is denigrated by the Exchange with the incredible argument that Mr. Rauschman, Walston's then Director of Compliance, and Mr. Cabell, Walston's house counsel, had no "responsibility to judge Crimmins' conduct" (EB at 38). More appropriate witnesses can hardly be imagined! The Exchange offered no evidence or law that the Charge 1 conduct was considered a violation of "just and equitable principles of trade" at the time in question. Its finding on this record, that the Charge 1 conduct violated such principles of trade, is arbitrary and unconstitutional because the standard applied was unconstitutionally vague (at least, men of common intelligence differed) and because there is nothing in the record to support the Exchange's conclusion that such conduct violated just and equitable principles of trade at the time in question.

The Exchange argues that SEC v. Lum's Inc.,supra is not applicable because it was not an Exchange disciplinary proceeding and because that case cannot be read as judicial approval of Crimmins' conduct EB at 39-40). However, Crimmins cites Lum's for the proposition that, at the relevant time, no regulatory agency had focused on the question of whether that conduct was improper; that at best this "was and is a murky area"; 365 F. Supp. at 1065. That Lum's was an SEC

proceeding is hardly a basis for distinction. The question would not be less "murky" in an Exchange proceeding. Judge Tyler's decision in Lum's (that the area was "murky" and not focused on by regulatory bodies) is a finding that in 1969 "men of common intelligence" had to "guess as to its [i.e. equitable principles of trade in the circumstances present in this case] meaning and differ[ed] as to its application." Connally, supra.

Finally, the Exchange argues (and Judge Lasker held, see 178a) that since Crimmins bound himself to abide by "just and equitable principles of trade", he cannot be heard to say that he was not aware of what that standard required of him. The short answer is he was aware that the standard did not prohibit his conduct but the Exchange has now modified the content of that standard, after the fact. Indeed, the Exchange has failed to cite any Exchange or other regulatory rule or proceeding which could have informed Crimmins that his conduct was improper. It is simply a violation of fundamental fairness to punish an employee for alleged "inequitable principles of trade", when nothing existed at the time in question to indicate that the particular conduct was prohibited, and when the employee acted with the endorsement of his superiors.

As applied to Crimmins in this case, the Exchange's standard is unconstitutionally vague and cannot support the sanction imposed.

IV

THE EXCHANGE DOES NOT RESPOND TO CRIMMINS' SHOWING THAT AS A MATTER OF LAW, HE DID NOT VIOLATE REGULATION T.

Instead of responding to Crimmins' demonstration that, as a matter of law, he did not violate Reg. T (MB at 32-39), the Exchange offers "alternative" grounds to support the District Court (EB at 48); i.e., grounds not relied on or discussed by the District Court nor even argued to the Exchange Panel.*

The Exchange argues that Crimmins was a "creditor" for Reg. T purposes because he was allegedly a "dealer" under 12 C.F.R. § 220.2(b). The Exchange concludes that because Crimmins had ten securities transactions for his own account, over a period of 18 months, he must have been engaged in the business of buying and selling securities for his own account and therefore he must be a "dealer" as defined by Section 3(a)(5) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78c(a)(5).

This argument is too far-fetched even under the non-restrictive reading of "dealer" urged by the Exchange

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* The Exchange decision gives no reason or basis for its conclusion that Reg. T was violated. Judge Lasker apparently held that he could affirm the Exchange's conclusion of a Reg. T violation, without finding a "legal" violation of the regulation, since the Exchange was only concerned with "ethical" conduct (179a). It is not clear what an ethical but not a "legal" violation of Reg. T would be.

(EB at 49-50). If adopted, virtually every stock market investor would be a "dealer". Professor Loss makes it quite clear that ordinary investors who trade even with some frequency are not "dealers" but "traders", 2 L. Loss, Securities Regulation, p. 1297 (1961). See also E. Weiss, Registration and Regulation of Brokers and Dealers, p. 8 (1965). It is to be noted that not even the opinion letter of a staff member of the Federal Reserve Board (126a-128a) relied on by the Exchange, attempted to use the theory that Crimmins was a "dealer".

The Exchange argues (EB at 50-51) that Crimmins' reading of Sutro Bros. & Co., 41 SEC 443 (1963) - that a salesman of a broker-dealer cannot himself be in violation of Reg. T. but can only "aid and abet" the violation of a broker-dealer (MB at 33-34) - is an unsupported assumption. Apart from the fact that Sutro clearly held as much, the Main Brief offers at least three other proofs that Crimmins was not a statutory broker-dealer (MB at 34-36) and the Federal Reserve Board has held that Reg. T can only be violated by a broker-dealer. Norman F. Swanton Associates, Current CCH Fed. Sec. L. Rep. ¶ 79,665 (Dec. 18, 1973).

Crimmins' two private purchases were neither within the terms nor the purposes of Section 7 of the 1934 Act (MB at 32-39). It is hardly unduly restrictive of the remedial

purpose of Section 7 to limit violations to those transactions which are within its terms and purposes. Crimmins has shown that his purchases were neither and the Exchange has offered no convincing argument to the contrary.

V

THE EXCHANGE FAILS TO REFUTE CRIMMINS' SHOWING THAT THERE WAS NO JUSTIFICATION OR PUBLIC INTEREST FOR THE PENALTY IMPOSED.

The Main Brief showed that Crimmins:

(1) acted at the direction and with the approval of his employer (MB at 25-26);

(2) acted in good faith without intent to violate any rule or standard (MB at 43-44);

(3) acted in an area where the law was "murky" (MB at 44-45); and

(4) was given a penalty far in excess of those imposed on others who had even been convicted of criminal violations in the same matter (MB at 45-46).

The Exchange's penalty, tantamount to expulsion, is outrageously harsh (MB 42-49). Moreover, the Panel made no finding of public necessity for its penalty as required by law and the record discloses no public interest for the penalty (MB 40-41).

The Exchange's only response is that penalties imposed in any two cases cannot be perfectly consistent since the facts of each case are different (EB at 57).* The problem with this argument is that it goes too far. It would legitimatize all penalties, including those indisputably unfair. Crimmins was given a penalty at least nine times as harsh as that imposed on any other person in the FSN debacle, including those persons indicted and convicted of securities fraud. Crimmins was not indicted but, as even the Exchange admits, accused of violations of ethical standards. Yet, the Exchange sought to "make an example" of Crimmins, effectively ending his 17-year securities career. The Exchange offers no answer to the charge that the law does not permit such "punitive" penalties, Beck v. SEC, 430 F.2d 673 (6th Cir. 1970).

In short, this is a case of an employee (1) acting in an area without rules prohibiting his actions, (2) acting with the approval of his supervisors, (3) inflicting no harm on the public (his alleged violation was to put himself into a potential conflict of interest) and then being subjected to (4) an unmercifully harsh punishment, after an unfair proceeding,

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* Notably, Judge Lasker seemed willing to make the comparison opposed by the Exchange but saw nothing to compare with (189a). As shown in the Main Brief, multiple bases of comparison of penalties were presented to the District Court (MB at 45-48).

effectively putting him out of business. It cannot be contended that by becoming a registered representative and subjecting himself to the Exchange's jurisdiction to protect the public, Crimmins thereby surrendered his rights to due process.

This Court should not put its judicial approval on the Exchange's arbitrary imposition of a cruel penalty, one based on considerations of punishment rather than public necessity.

CONCLUSION

For the reasons stated above and in the Main Brief, the decision of the District Court should be reversed and summary judgment entered in favor of plaintiff vacating or enjoining the enforcement of the Exchange's decision.

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Respectfully submitted,

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